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NABE Policy Survey

Business Economists Feel Federal Budget Deficits Will Remain Large;
Favor Restoration of a Lower Capital Gains Tax;
Are Worried about LBO-Generated Debt

March 1989

This report presents the results of a survey on economic policy issues made by nearly 300 business economists in late-January and early-February 1989. The **Economic Policy Survey** *is one of three surveys taken during each calendar quarter by NABE; the other surveys are the* **Industrial Outlook** *and the* **Macroeconomic Forecast.** *The release of this survey was timed to coincide with NABE's Economic Policy Seminar in Washington, D.C., on February 27-28, 1989.*

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Highlights from the February Survey

* The NABE panel overwhelmingly supports the objective of reducing Federal budget deficits. The business economists generally think the Gramm-Rudman-Hollings numerical targets are appropriate--but Washington policymakers will continue to be incapable of attaining the goals without tough, new actions. Most of the panel members would advocate reductions in Federal spending, and they propose a list of selective budget cuts. (Only some 15 percent would prefer an emphasis on increasing Federal revenues.)

* More than three-quarters of the business economists believe the Federal Reserve is focusing chiefly on the current inflation problem as the target of monetary policy. Given the expectations for a further run-up in inflation during 1989, 70 percent of the panel expects the Fed to boost interest rates further in the next 6 months. Eighty-one percent of the panel agrees with Fed policy.

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* By a 79-21 margin, the NABE panel believes President Bush's proposal to reduce the capital gains tax rate to 15 percent would improve capital formation. Beyond the first year, a narrow majority of the panel thinks Federal tax receipts would actually be raised through such a tax-law change. A 53-29 percent majority would favor making such a change in capital gains tax treatment irrespective of the group's concern about huge Federal budget deficits.

* The panel was asked more than two dozen specific questions about corporate restructurings, leveraged buy-outs, and mergers and acquisitions in terms of their risk, debt-burdens, economic efficiency and concentration of economic power. Perhaps surprisingly, the business economists are "cool" toward corporate restructurings in general (and LBOs in particular). They would not, however, advocate any actions to limit or restrict the process of restructuring. There is strong agreement that many corporate restructurings ultimately stem from imbalances in the tax laws, including the tax deductibility of corporate interest expense and the nondeductibility of dividend payments. The panel is concerned about the build-up of LBO-related corporate debt and the heightened degree of risk in a renewed recession.

Budget Policy

The NABE panel of business economists expects the Federal budget deficit for the 1990 fiscal year to be about $135 billion, a sizable improvement from the $170 billion estimated for the current fiscal year but well above the Gramm-Rudman-Hollings (GRH) deficit-reduction target. OMB Director Richard Darman was given about one chance in three of negotiating a successful deficit-reduction compromise with the Congress within the next several months.

Only two-thirds of the panel said the GRH targets are "appropriate"--many in the remaining one-third worry that attainment of the GRH targets, however unlikely this seems, would produce too much "fiscal drag" and slow the economy. But 94 percent of the panel said that additional action should be undertaken to lower the path of future budget deficits. A majority of the business economists would prefer to achieve a reduction of the budget deficit of $21 to 30 billion per year. (Implied here is a longer timetable for deficit-reduction than the GRH process. Depending upon the starting point, it might take 5 or 6 years to get close to a balanced budget, compared with the GRH timetable of 4 more years.)

When asked, "How should deficit reduction be accomplished," an overwhelming 76 percent responded that mostly reductions in Federal outlays should be utilized. About one-half favored a package that would also boost revenues. Only 15 percent would rely chiefly on revenue increases.

When asked for further elaboration of their preferred spending cuts, a majority of the panel would attack farm subsidies (and other farm income stabilization programs) and defense spending (especially, procurement). Forty-seven percent would trim the cost-of-living adjustments (COLAs) in the Social Security program. At the other end of the spectrum, the least-favored areas for spending cuts were on education, space and science programs, justice, natural resources and the environment, and housing, food and nutrition assistance. (See Table 1 below for the complete listing of the panel's responses.)

Table 1

Business Economists' Favorite Spending Cuts

*(Percent of NABE Panel Members Favoring Reductions in Federal Spending Programs, in Descending Order of Popularity, Dollar amounts are actual FY1988 Outlays, in billions * Denotes a Total or Subtotal of Spending Categories)*

Cut expenditures on farm income stabilization ($17.2)	72 Percent
Cut defense procurement ($77.2)	55
*Cut defense spending across-the-board ($290.4)	52
Cut Social Security COLA (about $6 billion)	47
*Cut domestic programs across-the-board ($647.2)	41
Cut medicare expenditures ($78.9)	38
Cut foreign aid, fgn. affairs, int'l finan. prog. ($10.5)	35
Cut commerce and housing credits (e.g., FHA, Postal Service, FSLIC ($18.8)	32
Cut misc. defense spending (e.g., mil.construction;$17.6)	31
Cut "general government" (e.g., operating, payroll; $9.5)	31
Cut non-Social Security retirement & disability ($52.2)	29
Cut Social Security outlays ($219.3)	29
Cut other health care (e.g., medicaid) ($44.5)	29
Cut defense outlays on personnel ($76.3)	28
Cut community & regional development ($5.3)	25
Cut Veterans programs ($29.4)	24
Cut transportation programs ($27.3)	23
Cut energy & conservation programs ($2.3)	22
*Cut all noninterest expenditures ($937.6)	22
Cut defense R&D ($34.8)	21
Cut defense operations & maintenance ($84.5)	18
Cut expenditures on social services ($8.0)	18
Cut other income security programs (e.g., SSI) ($27.9)	16
Cut unemployment compensation ($15.3)	15
Cut other training, employment, labor services ($6.0)	11
Cut assistance for housing, food, & nutrition ($34.0)	10
Cut natural resources & environment ($14.6)	9
Cut expenditures for justice administration ($9.2)	8
Cut space & science programs ($10.8)	7
Cut education expenditures ($16.7)	4

Among those who advocated raising revenues, usually in a package with spending cuts, by far the preferred route was an increase in gasoline excise taxes, with 71 percent favoring this option. A 51 percent majority advocated an increase in user fees (*e.g.*, entry fees to national parks). About one-third of those favoring revenue hikes would advocate a broader-based tax on all consumer energy products and services. Thirty-one percent would introduce a value-added tax (though we did not ask for amounts or trade-offs). Only 30 percent would raise the top personal income tax bracket to a marginal rate of 33 percent, as has been proposed in the Congress. Far down the list of preferences was a general increase in personal or corporate income taxes.

Monetary Policy

The Fed's conduct of monetary policy was solidly endorsed by the NABE policy panel. Seventy-seven percent said the current thrust of monetary policy was "about right," 13 percent worried that it might be too tight, and 8 percent felt it was too easy. About 60 percent thought the best indicator of monetary policy at present was the interest rate on Federal funds, with 29 percent thinking it was the growth rate on one of the measures of the money supply.

About two-thirds of the panel believes that monetary policy will be chiefly guided in the next 6 months by the rate of inflation (and inflation expectations). Another 24 percent thought it would be the pace of real economic growth.

Seventy percent of the NABE panel expect the Fed to boost interest rates still further in the coming 6 months. Another 22 percent think rates will remain flat at their current highs. Only 8 percent think rates will decline.

Longer term, a majority of the business economists think that the primary goal of monetary policy should be the attainment and maintenance of price stability. The runner-up in the survey was "maintaining (real) economic growth." Although business economists recognize that the goals of price stability and economic growth are usually complementary, there are times when they are competitive; for the majority of business economists, the current period appears to be such a time.

Capital Gains Taxes

President Bush has frequently advocated a reduction in capital gains tax rates. He received a modest endorsement from this group of business economists.

We raised 4 questions on this subject with our panel. Would Federal tax receipts be reduced in the first year of a reduction in capital gains taxes to a 15 percent rate? About one-third said, "No, Federal receipts would be raised," as Mr. Bush and some Treasury studies have suggested. About 56 percent said, "Yes, they would

decline." Eleven percent said there would be essentially no net change.

Beyond the first year, though, 47 percent thought a reduction in capital gains tax rates would boost Federal tax receipts, compared with 41 percent who thought receipts would decline. Twelve percent said there would be no net change.

Almost 80 percent felt such a tax-rate reduction would encourage capital formation, but 20 percent said there would be little net change (presumably after taking into account the possible reduction in Federal tax receipts).

Irrespective of the deficit impact, 53 percent of the panel said a reduction in the tax rate on capital gains would be "appropriate," compared with 29 percent saying "No" and 18 percent who were unsure.

Corporate Restructurings/LBOs/Mergers & Acquisitions

With the heightened concern in the media and in Washington about the role and impact of corporate restructurings--especially leveraged buy-outs (LBOs)--we asked a special set of questions of the NABE economic policy panel. There were some surprises in the results:

- Business economists are taking at best a "lukewarm" attitude toward the role, scope, and side-effects of corporate restructurings.

- Survey results show a "neutral" attitude toward the economic usefulness (that is, improving economic efficiencies and enhancing return on capital) of recent restructurings.

- The business economists are concerned that the "total social costs" (*e.g.*, cost to bondholders, employees, suppliers, customers, *etc.*) of corporate restructurings may have exceeded such positive characteristics as higher stock prices.

- The NABE panel does not draw a significant distinction (in terms of their actual experience) between LBOs and mergers or acquisitions.

- But the NABE panel decidedly does not want the government to restrict or restrain restructurings (*e.g.*, through a government review of "hostile" takeovers). The panel agrees solidly with the statement that financial restructurings of corporations should be uninhibited by government, except for the appropriate investigation and prosecution of violations of antitrust or securities laws.

- There is major agreement--the strongest reaction to *any* of our special questions--that corporate tax laws should be changed to bring into better balance the tax treatment of dividends and interest payments and thereby encourage equity capital formation.

- There has been insufficient application of Federal antitrust laws in recent years, but the panel finds there has not been an excessive concentration of market power in selected U.S. industries as a direct result of mergers or acquisitions.

NABE's panel of business economists is concerned about the decapitalization of American industry during the decade of the 1980s and the buildup of corporate debt. The panel "tends to agree" that the Fed's conduct of monetary policy would be potentially destabilized by the additional debt resulting from LBOs. In the event of a recession, the economists agree "quite strongly" that the high corporate debt levels will "probably aggravate" the slide in the economy.

The business economists quite strongly regard LBO-generated debt as being riskier than corporate debt generally. Therefore, the panel would agree with an increase in capital requirements for financial institutions providing financing for LBOs. The panel also would not permit government-insured deposits to be invested in loans or "junk bonds" that are issued as a result of LBOs or corporate takeovers.

NABE's panel expresses moderate concern over the potential abuses of inside information in the process of financial restructurings. Surprisingly, the group would support the concept of a required outside inquiry whenever management of a publicly-held company bids for ownership control to determine whether there has been adequate disclosure of relevant information to shareholders. The panel would also support delaying management bids for ownership control for, say, 90 days in order to permit disclosure of information and to permit other bidders to compete for ownership of the firm's shares. Similarly, the panel would not permit securities firms to underwrite securities in a company in which they have a direct (loan or equity) position in the company.